Briefing Paper

Voluntary Code for a Self-Financed Housing Revenue Account

November 2013

Introduction

In October 2013 the Chartered Institute of Public Finance & Accountancy (CIPFA) published its 'Voluntary Code for a Self-Financed Housing Revenue Account in conjunction with the Chartered Institute of Housing (CIH). The purpose of this briefing paper is to summarise and comment on the voluntary code.

In the forward to the code Ken Lee, Chair of the Housing Panel at CIPFA and Grania Long, Chief Executive of CIH say that:

"The introduction of Housing Revenue Account (HRA) self-financing has given local authorities the freedom to develop and deliver a more positive, less constrained, vision for council housing. The Chartered Institute of Public Finance and Accountancy and the Chartered Institute of Housing believe that it is vital that local authorities have effective governance and financial management frameworks in place in order for self-financing to be a success.

"In order to support local authorities in assessing and developing these frameworks the two institutes have worked together to produce a voluntary code of practice for the sector. The principles and provisions of this voluntary code will:

- *Assist housing authorities in ensuring effective governance, finance and business planning*
- *Provide transparency to tenants, members and officers on how the housing business is being managed. The code will give tenants and members a framework against which to hold the authority to account*
- *Allow housing authorities to assess where they may need further support and assistance.*

"In some cases, these principles are already covered through other regulatory or professional guidance. These are highlighted along with any specific provisions relating to a self-financed HRA.

"These principles are designed to be self-regulatory and we believe that they represent a key tool in assisting local authorities to account for the management of the HRA to tenants and residents and those charged with governance."

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The introduction to the code states that:

"Housing Revenue Account (HRA) self-financing commenced in April 2012. For the first time in generations, local housing authorities are able to fully retain the money they receive in rent in order to plan and provide services to their current and future tenants. This represents a monumental shift in outlook from the previous financial system, replacing an annual short-term focus with a longer term planning horizon with the freedom to develop and deliver a more positive, less constrained, vision for council housing.

"With freedom and flexibility comes responsibility. Councils are keen to make the most of this opportunity and do so in a prudent, viable and measured way. There are already a number of checks and balances in the system, including formal regulation of consumer standards in housing by the Homes and Communities Agency and the financial and accounting framework operating for local government. This document is designed to support councils in their aim to ensure effective and sensible management of the housing business and to be consistent with existing frameworks.

"Viable and sustainable council housing relies upon effective governance, financial and business planning. Decisions about appropriate arrangements for effective management of long-term housing business plans need to be decided and democratically accountable at the local level. However, there is an appetite within the sector for some guiding principles to assist in establishing those arrangements, and to demonstrate that councils are managing self-financing in a responsible and appropriate way."

At the launch of the code, CIPFA's lead housing advisor Dr Louise Dunne said:

"CIPFA and the CIH have been consulting with the sector over the past 18 months to develop a Voluntary Code of Practice for the Self-financed HRA. Its aim is to fill the regulatory gap with regard to financial viability and governance, and provide an opportunity through 'self-regulation' and voluntary sign up, for local housing authorities to demonstrate unequivocally that they can indeed be trusted to manage their own affairs.

"This code will give assurance to local authorities in accounting for the management of their Housing Revenue Account to tenants, rate payers and government. When resources are stretched and budgets are tight, local authorities need something to help them realise their goals easily and cost effectively. The new joint CIPFA and CIH code… provides just that."

"The launch of this code today marks the beginning of 'localism' at its best – with 'regulation' for the sector, by the sector."

Ben Taylor, Assistant Director at CIH consultancy, added:

"Local authorities need to ensure they have appropriate arrangements in place to manage their self-financed HRA. This principles-based code will give a framework to stock-owning councils to help the HRA remain viable while contributing fully to meeting housing needs in a way that is accountable to tenants, members and other stakeholders."

In referring to a 'monumental shift' CIPFA and CIH could be accused yet again of viewing self-financing through 'rose tinted spectacles'. Self-financing does remove the annual housing subsidy determination and the uncertainty that this created thus creating a better environment. However, it also involved a significant increase in debt that must be serviced by local authorities and their tenants; the imposition of the 'borrowing cap' that prevents councils from borrowing to improve existing homes or to build new homes even if they can afford to do so; and a change in rent policy that leaves some authorities with less income in reality than was assumed when the government imposed the increased debt.

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It could be argued that the need for effective and sensible management, effective governance and financial and business planning is not new and that many authorities had these in place before the code was published or even before self-financing was introduced. However, the need for these things clearly exists and the code provides a useful checklist for ensuring that they are in place. Indeed, the code recognises that:

"Councils have responded to the move to self-financing by putting in place formal and comprehensive objectives, policies and practices, strategies and reporting arrangements for the effective management and control of their self-financed HRA."

Status and How the Code works

The code describes its status and how it works as follows:

"This is a voluntary code of practice covering six principles. Along with these high level principles, the code comprises a series of supporting provisions which together describe what the sector considers as essential elements for the continued sustainability of a self-financed HRA. In some cases, these principles are already covered through other regulatory or professional guidance. In these cases, this is stated along with any specific provisions relating to a self-financed HRA.

"The code is designed to be self-regulatory and compliance is not formally required. As such there are no formal entry level requirements and no formal sanctions for non-compliance. It will be for a housing authority to determine how it wishes to assess its compliance with the code on an on-going basis and this reflects our belief that this code is a tool to assist the authority to account for the management of the HRA to its stakeholders. One option available to housing authorities is to undertake reviews of compliance with the code and report these reviews to the appropriate scrutiny groups and include them within the authority's Annual Governance Statement. Where an authority does not feel it is complying with the code, it is a prompt to review its approach and question whether different things need to happen.

"The voluntary code has the support of a wide range of organisations, including those who work alongside tenants and residents – this set of principles and provisions is intended to support these groups and individuals to better challenge and scrutinise the performance of the HRA under self-financing.

"Finally, it is not intended that any of the Principles or Provisions as set out in this code will override or countermand Statute."

Principles

The code is based on six principles as follows:

1. **Co-regulation.** The housing authority complies with the principles of co-regulation as set out in *The Regulatory Framework for Social Housing in England from April 2012*.

2. **Financial viability.** The housing authority has put in place arrangements to monitor the viability of the housing business and takes appropriate actions to maintain viability.

3. **Communications and governance.** The housing authority keeps under review the communications and governance arrangements with regards to the new operating environment and adopts governance arrangements appropriate to supporting viability and accountability of the housing business.

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4. **Risk management.** The housing authority has in place an effective system for the on-going management, monitoring and reporting of risks to the HRA.

5. **Asset management.** The housing authority has in place arrangements to maintain its assets to maximise their value into the future. The authority complies with the principles of good asset management as they apply to HRA assets.

6. **Financial and treasury management.** The housing authority complies with proper accounting practices including CIPFA's *Code of Practice on Local Authority Accounting in the United Kingdom* and CIPFA's *Treasury Management in the Public Services Code of Practice*

These principles are remarkably uncontroversial and largely reflect existing legislative requirements and accepted good practice in local government. For example on co-regulation the code merely points out that authorities need to comply with six provisions of the existing regulatory framework and adds:

"Financial and other performance information is presented in a format that is inclusive to all."

Financial Viability

On financial viability the code has more to say and contains five provisions as follows:

Provision 1: The housing authority has put in place a business planning process underpinned by appropriate financial modelling that allows the cash flows of the business to be forecast. The process incorporates an appropriate set of assumptions relating to forecast:

- Rent levels
- General income and expenditure levels
- Interest rates on investment and borrowing, and associated costs
- Levels of void properties and bad debts.

Provision 2: The housing authority tests the viability of proposed major capital expenditure projects against the resources generated in the business plan. This ensures that additional activity (for example the development of new housing) is fully integrated into the business planning process and does not introduce liabilities that are unable to be fully funded within an appropriate timescale.

Provision 3: The housing authority ensures that sufficient resources are allocated for the long-term maintenance of the stock and other assets, adopting an appropriate mechanism to transfer resources from revenue to a reserve ensuring that the peaks and troughs of lifecycle investment needs are able to be met.

Provision 4: Assumptions are kept under regular review and tested against actual financial performance. Alterations to underlying assumptions are made in direct relation to the impact on the overall plan.

Provision 5: The housing authority maintains accurate data about the cost of its services, and regularly reviews these in relation to its procurement and commissioning strategies. The business plan allocates resources to ensure the continued viability of high quality management services.

This appears to represent a fairly standard checklist of financial viability.

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Communications and Governance

There are six provisions on communications and governance:

Provision 1: The housing authority undertakes to achieve openness in communication and sharing of information, and expresses all internal and governance communications in clear language.

Provision 2: The housing authority engages in appropriate levels of consultation with tenants, members, officers and other stakeholders in a way that ensures it delivers efficient management and control of its business plan.

Provision 3: The housing authority reviews on a regular basis the quality, accuracy and utility of all information pertaining to the management of its housing business including financial and performance based sources.

Provision 4: The housing authority has an appropriate mechanism to assess its on-going compliance with the key principles and accounts to residents on this compliance. One option could be to undertake to publish a commentary on its compliance as part of its Annual Governance Statement or through other appropriate channels.

Provision 5: The housing authority has adopted suitable governance arrangements consistent with the effective operation of a housing business, paying attention to the long-term nature of the business: incorporating for example the need to plan maintenance and investment over the long term and the need to manage large levels of long-term housing debt.

Provision 6: The housing authority ensures that resources are appropriately allocated between investment, maintenance and management priorities in line with business plan objectives and that the balance of priorities is agreed with tenants, members and other stakeholders as appropriate.

The code's interest in governance and communications is to be welcomed. It is part of the growing realisation that good financial management is, to a large extent, about good communication. However, the emphasis appears to be on how the local authority should provide information to tenants and other stakeholders. It is possibly even more important to develop mechanisms through which tenants and stakeholders can be empowered to influence the decisions that are taken about the management of the housing revenue account.

Risk Management

There are three provisions on risk management:

Provision 1: The housing authority carries out appropriate sensitivity analysis across the business plan to identify potential high, medium and low level risks to the financial viability of the HRA. In particular, attention is given to evaluating risks arising from: changes in government policy; treasury management risks; inflation; income recovery rates; void levels; changes to rent policy; changes in the composition of the stock; investment return; right to buy; debt levels and grants.

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Provision 2: The housing authority has a risk management system in place which, as a minimum, includes the following processes:

- Identification of risk
- Quantification of risk
- Management of risk
- Re-assessment of risk
- Communication of risk to appropriate decision-makers.

Provision 3: The housing authority identifies appropriate mitigating actions where higher level risks to the overall sustainability of the business plan are identified, to ensure the long term viability of the HRA. These may include:

- An active treasury management strategy and procedures to manage treasury management risks in accordance with CIPFA's *Treasury Management in the Public Services Code of Practice*
- A suitable level of balance of reserves maintained by the HRA as a contingency against risks on inflation and income, bad debt increases as well as investment risk
- Performance management frameworks effectively enforced to manage the risks of poor performance in voids, income collection and investment scheme delivery.

The code is correct to emphasise risk management as this is an area that many local authorities should consider developing. Too often local authorities focus on the financial scenario that they think most likely – the approved business plan and budget – and give insufficient attention to alternative scenarios that may require a different response – risk assessment and management.

It could be argued that reporting to elected members should focus on risk management, identifying the key assumptions and forecasts that are made in the business plan and budget, the key risks that those assumptions and forecasts may not prove accurate, how to mitigate and manage those risks, and then monitoring the extent to which the assumptions, forecasts and risks are realised in practice.

Asset Management

There are five provisions for asset management:

Provision 1: The housing authority takes a strategic approach to asset management ensuring that the long-term strategic vision for the authority is underpinned by a thorough understanding of current and future needs.

Provision 2: The housing authority's strategic asset management and business planning processes are fully integrated. The business plan supports the maintenance and development of the asset base which in turn provides value to the business plan.

Provision 3: The housing authority has agreed asset management standards with tenants, members and other stakeholders having regard to the financial resources generated within the business plan.

Provision 4: The housing authority maintains accurate information relating to the condition, maintenance and investment needs of its housing stock and other HRA assets.

Provision 5: Asset management information forms the basis for the asset investment programme of the housing authority driven by the business plan and set out over an appropriate medium-term financial period.

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This appears to represent a fairly standard checklist of how to integrate asset management into business planning.

Financial and Treasury Management

The code points out that this is largely a matter of complying with established good practice and says that:

"The housing authority complies with proper accounting practices including CIPFA's Code of Practice on Local Authority Accounting in the United Kingdom and CIPFA's Treasury Management in the Public Services Code of Practice."

However, the code adds two provisions:

Provision 1: Housing is a long-term investment and HRA borrowing policy needs long term stability to ensure long-term planning is undertaken on a reasonable and consistent basis. The housing authority has set out a policy stating how a reasonable charge for borrowing costs of the HRA will be calculated, set for the long-term such that it enables long-term planning of HRA resources and borrowing.

Provision 2: The depreciation charge to the HRA is calculated on a componentised basis in line with proper accounting practices. The housing authority is moving to a full depreciation accounting charge in line with the transitional arrangements set out by the Department for Communities and Local Government.

Provision one appears to represent a statement of established good practice.

I think that provision two is rather disappointing.

It is now a requirement for local authorities to comply with International Financial Reporting Standards that includes a requirement to calculate depreciation on a componentised basis. Leaving aside the issue regarding whether councils can avoid this provision where they can argue that it is not 'material', the code does no more than state the legal position.

Similarly, local authorities will already be aware that they must comply with the transitional arrangements set out by the Department for Communities & Local Government. However, these transitional arrangements are merely a mechanism for postponing the introduction of one of the aspects of self-financing: the use of the depreciation calculation to decide how much money to transfer out of the housing revenue account and into the major repairs reserve where it is used to fund major repairs.

The issues are outlined in detail in my briefing paper on accounting for self-financing that can be found at http://www.awics.co.uk/accountingsf.asp . However, the main issue is this: When the government calculated how much debt each local authority could take on it used the 'major repairs allowance' to calculate how much they would transfer to the major repairs reserve to pay for major repairs. The major repairs allowance was one of the elements in the calculation of housing subsidy. The government then decided that it wanted local authorities to transfer a figure equivalent to depreciation into the major repairs reserve. If depreciation was significantly higher than the major repairs allowance this figure could be unaffordable. Government also wanted 'impairment' (the writing-down of the value of capital assets other than as a result of planned depreciation) to become a real charge in the HRA rather than a notional one.

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Following representations, Communities & Local Government agreed that there would be a five year transitional period during which councils could continue to use the major repairs allowance and treat depreciation and impairment as 'notional' rather than 'actual' charges. However, this still leaves open the question of what will happen after 2017. The code provides no more information on this.

As Lesley Lodge, Finance & Policy Manager at CIPFA, wrote in 'Public Finance' in November 2013:

"There have been unforeseen problems… with the new, transitional arrangements for depreciation and impairment. CIPFA is involved in detailed discussions with the Department for Local Government and Communities on possible, more workable ways forward in these areas. Meanwhile, it pays to understand the small print around those arrangements."

I am afraid that the depreciation / impairment / major repairs issue may arise from a fundamental flaw in the way that self-financing was introduced and that finding a solution without re-visiting the debt settlement or some of the provisions of the 1989 Local Government & Housing Act may be difficult.

Conclusions

The code of practice is a voluntary code and there are therefore no sanctions for not following it. However, it appears to contain nothing controversial and represents a useful check list based on common sense. It should therefore be welcomed by local authorities and their tenants.

However, its silence on the future treatment of depreciation, impairment and major repairs is a disappointment.

Adrian Waite - November 2013

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February / November 2014

We are running our 2014 series of 'All You Want to Know about Local Authority Housing Finance' at venues in all parts of England from February to November. This seminar and workshop is designed to give an introduction and overview to this important subject and is fully up to date with all developments.

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What the Session Covers:

The session will answer the following questions:

- How does the Housing Revenue Account work?
- How does the Housing General Fund work?
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Venues and Dates:

London: *Novotel Hotel, Waterloo – 26th February 2014.*
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The seminar is also available in-house.

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